

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554**

Comments on	)	
	)	CC Docket No. 96-45
Joint Board	)	DA 98-2410
<i>Second Recommended Decision</i>	)	
	)	

**COMMENTS OF  
THE RURAL TELEPHONE COALITION**

Margot Smiley Humphrey  
Koteen & Naftalin, LLP  
1150 Connecticut Ave., NW  
Suite 1000  
Washington, DC 20036

L. Marie Guillory  
Jill Canfield  
NTCA  
2626 Pennsylvania Ave., NW  
Washington, DC 20037

Stuart Polikoff  
Stephen Pastorkovich  
OPASTCO  
21 Dupont Circle, NW  
Suite 700  
Washington, DC 20036

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## SUMMARY

The Joint Board's Second Recommended Decision rightly excluded rural ILEC areas from its decision to reaffirm the use of a FLEC proxy model for non-rural company areas because the Commission has made a commitment not to disturb the universal service support system for rural ILECs until 2001 at the earliest, after the impact of any proposed substitute for rural consumers has been evaluated and verified. In fact, the recommended decision and the Joint Board members' separate statements disclose that the proxy model is not at a stage where a final recommendation for the proxy approach is possible for non-rural ILECs, since inputs have not been chosen, the model has not been verified even for non-rural areas, too little is known to judge whether support will be "sufficient," the use of study area averages cancels out a major purpose for the model, and it is unclear how the funds will be used or that carriers will not be rewarded for failing to upgrade their networks.

The recommendation would wisely abandon the 25% federal support ceiling for non-rural support to focus on "reasonably comparable" rural and urban rates and the support necessary to achieve that statutory dictate. The Joint Board understood that comparability applies across state boundaries and requires a nationwide approach to support to successfully implement that principle in very rural Wyoming as well as in urban-dominated New York. The Joint Board also realized that some states may require more federal support to satisfy the statute's requirements, and retreated from the Commission's earlier notion that the Act requires immediate shifting of state and interstate implicit support flows to explicit mechanisms. However, until the Joint Board's vague definition of comparability is further refined, the sufficiency of the resulting support cannot be fully evaluated. Furthermore, the Commission should realize that its "hold harmless" promise to Congress was not limited to the "explicit" support the Joint Board now proposes to maintain for each state.

The Joint Board was wrong to recommend a federal system that only provides support beyond a point that regulators will establish to ensure that every state first generates as much support internally as it reasonably can. This recommendation undercuts the Joint Board's own valid determination that the statute does not permit a federal mandate for any state universal service fund or federal support that is contingent on state support. The Joint Board's reasonable state effort test has precisely that effect by setting a floor for federal support regardless of whether the state funds the difference or leaves customers without the federally required "reasonably comparable" rates and services. There is simply no statutory authority for calculating in a factor for reasonable state efforts before federal support kicks in.

The Commission should extend six salutary principles in the non-rural recommendation for rural ILEC areas as well. Rural customers and states — for which the Act enacts special safeguards so that states may buffer the transition to competition — also need a "hold harmless" approach to any post-Act changes in the federal support programs to ensure stability. The 25% federal support ceiling should also be rescinded for rural ILEC areas, where the Commission was mistaken in claiming that 25% was the former limit of their federal support in the first place. The same problem with state-to-state rate differences should also dictate the substitution of a high cost benchmark for the May 8 Decision's revenues benchmark which relies on nationwide average revenues that rural companies may not ever see. Next, the Commission should allocate carrier contributions using total, unseparated revenues for rural ILEC support under the transitional plan and any future system both to avoid the burdens, uncertainties, and opportunities for manipulation inherent in making unregulated carriers identify revenues by jurisdiction and to employ the same contribution basis for all federal programs. For all the reasons that warrant rejection of block grants to states and federal mandates for state rate restructuring, the Commission should also extend those policies to rural ILEC areas.

The Commission should, however, discard — or at least not ever extend to rural ILEC support — several errors in the recommendation. First, it should repudiate the unlawful focus on imaginary net state “contributor” and “receiver” status in all of its universal service deliberations and cleave to the clear mandates Congress set forth in the Act to decide what amount of federal support will be sufficient to provide reasonable comparability. It should also reject the notion that its role is to cap or “size” the fund, rather than looking at the statutory mandates and ensure that federal support is “sufficient.” The statutory result-based standards for universal service support also demand that the Commission give first priority to delivering on the principles in Section 254 to customers, rather than attaching paramount importance to shaping support to the needs of competitors. The Joint Board’s reversion to a plan with study area average support also highlights the pressing necessity to deal with the perverse incentives, ILEC customer support shortfalls, and competitor windfalls that plague the current mismatch between ILEC and new entrants’ responsibilities, preferably by disaggregating support when it is portable. Letting states require CETCs to target support to their highest cost customers is no remedy when the CETC serves the ILEC’s highest cost customers by subsidized resale or, if it has a different service area, not at all.

The Joint Board properly recommended Commission guidance on the characterization of universal service charges to subscribers. Consumer understanding that support for universal service is not a new burden will enhance the Commission's ability to successfully implement the goals of the Act.

Finally, the Commission should not deduct any implicit support it makes explicit from interstate access charges without ensuring that it is replaced by the federal share of support, since otherwise it will merely have transferred the problem to the states. To

prevent this, the Commission should add any support shifted from implicit to explicit to the “hold harmless” rule for companies and states.

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**COMMENTS  
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**I. INTRODUCTION**

The Rural Telephone Coalition (RTC) files these comments in response to the Universal Service Joint Board's Second Recommended Decision. The RTC is comprised of the National Rural Telecom Association (NRTA), the National Telephone Cooperative Association (NTCA) and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO). Together, the three associations represent more than 850 small and rural telephone companies.

## **II. THE JOINT BOARD PROPERLY DECLINED TO EXTEND ITS RECOMMENDED FLEC PROXY MODEL DECISIONS FOR NON-RURAL ILECS TO RURAL ILECS**

### **A. The Joint Board Properly Reiterated the FCC Commitment Not to Alter the Universal Service Support Mechanism for Rural ILECs' Before January 1, 2001**

Though the Commission's work on a national forward-looking economic cost (FLEC) proxy model has not yet been completed, the Joint Board's Second Recommended Decision tentatively reaffirmed support for the use of a national FLEC proxy model to calculate non-rural incumbent local exchange carriers' (ILECs) high cost support.<sup>1</sup> This recommendation was made despite the inherent uncertainty related to the Commission's (or any) model<sup>2</sup> and the fact that *no* cost estimates can be provided or evaluated until inputs have been selected.<sup>3</sup> Nonetheless, the Joint Board expressly recognized that implementation of this new federal mechanism could cause carriers to "receive more or less support than in the past," potentially leading to rate shock for some consumers.<sup>4</sup>

The uncertainty surrounding the use of a proxy-based, FLEC mechanism, in conjunction with the well-recognized potential for a substantial reduction in the support provided to some carriers continues to underlie the RTC's position that the Commission's adopted cost methodology does not currently meet the 1996 Telecommunications Act's (the Act) requirements for sufficiency and predictability. For this reason, the RTC

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<sup>1</sup> *Federal-State Joint Board on Universal Service*, Second Recommended Decision, CC Docket 96-45, FCC 98J-7, (rel. Nov. 25, 1998), para. 9 (Second Recommended Decision).

<sup>2</sup> "[M]odels lead to inherent uncertainty and instability." "[T]he instability of empirical economics cannot be overcome with ever better models; it is rather a property of using models themselves." *Ibid.*, Dissenting Statement of Commissioner Harold Furchtgott-Roth, p. 3.

<sup>3</sup> *Federal-State Joint Board on Universal Service*, Forward Looking Mechanism for High Cost Support for Non-Rural LECs, CC Docket Nos. 96-45, 97-160, FCC 98-279 (rel. Oct. 28, 1998).

<sup>4</sup> Second Recommended Decision, para. 51.

strongly supported statements made earlier this year by FCC Chairman William Kennard concerning the success of rural telephone service under the traditional universal service mechanisms.<sup>5</sup> Chairman Kennard expressly recognized that pending issues in the Universal Service docket may not be resolved until beyond 2001, and that “2001 is not a target date.” He said, “High cost support for rural telephone companies is working well, and it should not be changed until we know that the changes we implement will provide adequate and appropriate high cost support.”

The RTC agrees with the Joint Board in reiterating the Commission’s commitment to alter the high cost support mechanism for rural carriers only after January 1, 2001, and in no event before the Joint Board has completed further deliberations on high cost support mechanisms for rural carriers in light of the recommendations received from the Joint Board-appointed Rural Task Force.<sup>6</sup> The Joint Board’s proper recommendation not to alter the rural high cost support mechanism at this time is both consistent with the statutory requirement of “specific, predictable and sufficient”<sup>7</sup> federal support and Chairman Kennard’s statements recognizing that January 1, 2001 is merely an artificially imposed target date.

**B. The Joint Board Correctly Recognized that Even its FLEC Recommendation for Non-Rural LECs Could Only be Tentatively Adopted**

As mentioned *supra*, the recommended “framework” for the non-rural federal support mechanism cannot be properly evaluated, because the chosen FLEC proxy model remains incomplete. Thus, the Joint Board correctly stated that even its recommendation for non-rural LECs to use the FLEC proxy model that is still under development is

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<sup>5</sup> Remarks by FCC Chairman William Kennard to USTA’s Inside Washington Telecom, April 27, 1998.

<sup>6</sup> Second Recommended Decision, para. 52.

<sup>7</sup> 47 U.S.C. § 254(b)(4).

necessarily tentative, and implementation may be further delayed pending the outcome of the Commission's proceeding to determine inputs.<sup>8</sup>

Nevertheless, the Joint Board remained committed to a "framework" that still cannot meet the initial criteria set forth by the Commission in its May 8, 1997 *Universal Service Order*.<sup>9</sup> The RTC cannot agree with this Joint Board's recommendation concerning the use of FLEC as determined by a cost proxy model.<sup>10</sup> Numerous comment cycles and thousands of man-hours have not produced sufficient evidence that the model's results can be properly verified for use in determining support. Basic questions concerning the validity of the model for the purpose of calculating costs still remain even with members of the Joint Board. In fact, five of the Joint Board members specifically express serious concern over the lack of *resulting numbers* available for review.<sup>11</sup>

Therefore, the RTC questions whether there is any record basis for the Joint Board's conclusion that "model results will furnish reasonable cost averages for all regions of the country."<sup>12</sup> Only a completed, validated mechanism can be properly tested, yet the Second Recommended Decision lacks an articulated plan for verification. Apparently, the Joint Board is still relying on the testing of inputs only, having no *results* to examine.<sup>13</sup> The RTC agrees with Commissioner Susan Ness that the model must achieve a "level of accuracy, predictability and openness that earns it broad acceptance."<sup>14</sup> Even more

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<sup>8</sup> Second Recommended Decision, para. 29.

<sup>9</sup> *Federal-State Joint Board on Universal Service*, Report and Order, CC Docket No. 96-45, 12 FCC Rcd. 8776, para 250 (rel. May 8, 1997) (May 8 Decision).

<sup>10</sup> Second Recommended Decision, para. 27.

<sup>11</sup> *Id.*, Joint Statement of Chairman Julia L. Johnson and Commissioner David Baker, p. 2; Separate Statement of FCC Commissioner Gloria Tristani, Dissenting in Part, p. 1; Separate Statement of Commissioner Laska Schoenfelder, Dissenting, p. 1; Furchtgott-Roth, p. 7.

<sup>12</sup> *Id.*, para. 29.

<sup>13</sup> However, the RTC notes that Chairman Julia Johnson and Commissioner David Baker state their intention to support the continuance of the existing mechanism unless the model produces "consistent and rational *results*." *Id.*, Johnson & Baker, p.2 (emphasis added). *See also*, Schoenfelder, p. 1.

<sup>14</sup> *Id.*, Separate Statement of Commissioner Susan Ness, p. 1.

fundamentally, it must be demonstrated that use of a model will result in universal service as mandated by the Act. Yet the question remains: How will the Commission conclude that these tests are met?

Moreover, if, as the Joint Board suggested, the Commission decides not to alter the total recovery for non-rural companies and continues to use study area average costs, the traditionally touted benefits to the FLEC model seem to disappear, while the model would ultimately reward carriers that do *not* invest in the network. In her dissenting statement, Commissioner Schoenfelder explained:

No one proposes that the carriers that receive the support build that [efficient] network. The use of the model may ultimately reward companies that have not been aggressive in building or upgrading their networks and may penalize companies that have been diligent in constructing state of the art networks. The customers will ultimately will carry the burden of the fund.<sup>15</sup>

While Section 254 requires the use of support funds only for the provision of universal service, the Joint Board failed to articulate any practical means of enforcing this requirement, especially for newly designated competitive eligible telecommunications carriers (CETCs) that have no history or experience with providing universal service. A certification requirement devoid of an explicit standard for measurement puts carriers at risk of prosecution for not meeting some post-hoc requirement. In contrast, the pre-Act universal service programs provided support only for costs that had actually been incurred.

Finally, the RTC agrees wholeheartedly with Commissioner Furchtgott-Roth's statement reiterating that the nation's universal service policy as mandated by the Act is one based on equity and fairness, not economic efficiency.<sup>16</sup> Section 254 was not written to promote competition in rural America, though this objective seems to take precedence in the Joint Board's recommendations. The goal of Section 254 is to insure that service in

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<sup>15</sup> *Id.*, Schoenfelder, p. 1.

<sup>16</sup> *Id.*, Furchtgott-Roth, pp. 5-6.

rural areas is comparable in price, quality and offerings to the service enjoyed by non-rural consumers. Any recommendation adopted by the Commission must reflect this goal.

**C. The Joint Board Wisely Reiterated that its Substitution of a FLEC Proxy Model Approach for Non-Rural ILECs Instead of the 25% Interstate Support Share is Not a Precedent for Rural Universal Service Determinations Involving Joint Board and Rural Task Force Recommendations<sup>17</sup>**

Supporting the Commission's "hold harmless" commitment not to reduce current levels of explicit high cost support to states and non-rural carriers, the Joint Board recommended that the Commission abandon the 25/75 jurisdictional division of responsibility for funding non-rural, high cost support. Instead, it suggested a two-step methodology for non-rural high cost support that would have the Commission first select a single, national cost benchmark against which the proxy-produced, forward-looking cost of service in a given study area can be compared to determine whether that study area has costs above the national average. The second step would involve calculating the "level of support that could equitably and reasonably be assumed to be provided by implicit or explicit state support."<sup>18</sup>

The RTC certainly agrees that the application of the unlawful 25% federal support share should be rescinded. Any cost recovery approach for the federal mechanism that is not a national one cannot produce equitable results, is contrary to Section 254(b) of the Act, and needlessly discriminates against customers in states with large rural populations.<sup>19</sup> Nonetheless, the RTC concurs with the Joint Board that the non-rural ILEC universal service recommendation to substitute a FLEC proxy benchmark cost approach for the 25% federal support ceiling should not ever indicate a predisposition on pending rural ILEC universal service issues. Indeed, the Joint Board properly emphasized that its

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<sup>17</sup> *Id.*, para. 30.

<sup>18</sup> *Id.*, para. 44.

<sup>19</sup> *See*, RTC Comments, CC Docket Nos. 96-45, 97-160, May 15, 1998.

Second Recommended Decision is not intended to create “any precedent for any potential revisions to support mechanisms for rural carriers,” and further stated:

The model platform that the Commission adopted in October was designed to estimate *non-rural carriers’* cost. Pursuant to the Joint Board’s recommendation, the Commission has provided that the determination of the appropriate manner in which a model should be applied to rural carriers, **if at all**, will take into account the recommendation of the Joint Board, after the Joint Board receives a report from the Rural Task Force.<sup>20</sup>

Despite this clear statement from the Joint Board recognizing that universal service decisions for non-rural companies are not precedent for rural companies, past experience has proven that decisions affecting larger ILECs are often later applied to rural companies, regardless of such statements. Indeed, Commissioner Furchtgott-Roth refers to this likely outcome in his dissent: “It is not unanticipated that this model could be used for the small rural carriers.”<sup>21</sup> It is probably for this reason that the Rural Task Force explicitly asked the Joint Board “to clearly indicate that recommended actions pertaining to universal service reform for non-rural companies are not precedent for ultimate universal service reform (if any) which may be appropriate for rural companies.”<sup>22</sup> The Joint Board’s statement that the Rural Task Force is not bound to the adoption of a model provides a far better foundation for the work of the Rural Task Force, the Joint Board, and the Commission on appropriate mechanisms for rural companies.

### **III. THE JOINT BOARD PROPERLY FOCUSED ON “COMPARABLE RATES” AND SERVICES AND “SUFFICIENT” SUPPORT**

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<sup>20</sup> Second Recommended Decision, para. 30 (emphasis added).

<sup>21</sup> *Id.*, Furchtgott-Roth, p. 11.

<sup>22</sup> *See*, Rural Task Force Letter to the Joint Board, urging the Joint Board in “making its recommendations on referral issues to clearly indicate that recommended actions pertaining to universal service reform for non-rural companies are not precedent for ultimate universal service reform (if any) which may be appropriate for rural companies.”

The Joint Board is to be commended for rejecting the arbitrary 25% federal ceiling on the necessary support to provide federally-defined universal service. Among other shortcomings, the 25/75 jurisdictional division of responsibility ignored the Act's requirements that the federal mechanism provide "sufficient" and "predictable" support. In addition, placing 75% of the funding responsibility on the states would unravel the nationwide support mechanism Congress enacted, thereby threatening the achievement of rates that are "affordable" and "reasonably comparable" between rural and urban areas, particularly in states with large rural populations. Instead, the Joint Board's recommendation properly refocuses the Commission's attention on the sufficiency of federal support and the comparability of urban and rural rates, both within and across state lines.<sup>23</sup>

The Joint Board was correct to recognize that the federal urban/rural comparability requirement of Section 254(b)(3) of the Act applies across state lines as well as within a state's borders<sup>24</sup> and must be implemented through a nationwide mechanism.<sup>25</sup> Only through a singular, nationwide definition of comparability and a nationwide support mechanism can it be ensured that, for example, high cost customers in Wyoming, with a small urban customer base from which to derive internal support, will have rates reasonably comparable to subscribers in a state such as New York with a sizable metropolitan populace.

The Joint Board also properly recognized that in order to actually achieve uniform

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<sup>23</sup> Second Recommended Decision, paras. 4, 17.

<sup>24</sup> *Id.*, paras. 15, 18, 37, 48.

<sup>25</sup> *Id.*, paras. 14, 37.

comparability among all the states, some high cost, rural states may require additional federal support beyond their current support levels.<sup>26</sup> However, the Joint Board's recommendation to use federal support only as a supplement to a state's own resources<sup>27</sup> may deny consumers the comparable rates which Congress made a responsibility of the federal mechanism. In any event, until the FCC more narrowly defines comparability beyond a "fair range" of urban/rural rates,<sup>28</sup> the sufficiency of the definition as well as the sufficiency of the resulting support cannot be fully evaluated. The Joint Board, in its recommendation, states that until it resolves other pending policy decisions, it is not possible to define in dollars the amount of support required by the comparability standard.<sup>29</sup> One of the policy decisions that will require resolution is a more precise definition of "reasonable comparability" in order to determine the dollar amount of "sufficient" federal support, under the Act, and to ensure the close relationship between rural and urban rates and services that Congress intended.

The RTC was gratified to see the Joint Board support the Commission's commitment that states will not receive less high cost assistance under the new federal mechanism than they presently receive.<sup>30</sup> A "hold harmless" provision in the new mechanism will provide a reasonable baseline of support to the states and carriers and prevent customer rate shock should the new federal mechanism result in some carriers receiving less support than they do under the present mechanism. The RTC is concerned, however, with the Joint Board's interpretation of the Commission's commitment to be

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<sup>26</sup> *Id.*, paras. 40, 48.

<sup>27</sup> *Id.*, para. 44.

<sup>28</sup> *Id.*, paras. 15, 18.

<sup>29</sup> *Id.*, para. 48.

limited only to explicit support mechanisms.<sup>31</sup> Limiting the hold harmless “backstop” to only explicit funding may result in insufficient support for some carriers if implicit support continues to be removed from interstate access charges and is not replaced, dollar for dollar, in the high cost fund. As Commissioner Furchtgott-Roth pointed out in his dissenting statement, the Commission’s remarks in its Report to Congress regarding a hold harmless policy strongly suggest that its commitment applied to both explicit and implicit support mechanisms.<sup>32</sup> Specifically, the Commission stated:

[W]e conclude that a strict, across the board rule that provides 25% of unseparated high cost support to the larger LECs might provide some States with less total interstate support than is currently provided through **aggregate implicit and explicit federal subsidies**. The Commission will work to ensure that states do not receive less funding as we implement the high cost mechanisms under the 1996 Act.<sup>33</sup>

It would be disingenuous for the Commission now to say that its commitment was only intended to apply to explicit support. The Commission must not go back on its word to Congress, the states, carriers, and subscribers. It should adopt a provision that holds both states and carriers harmless for their total level of current support, both explicit and implicit.<sup>34</sup>

#### **IV. THE JOINT BOARD’S ASSERTION THAT FEDERAL SUPPORT SHOULD ONLY SERVE TO SUPPLEMENT STATE SUPPORT IS CONTRARY TO THE ACT**

The Joint Board is misreading the Act when it declares that “[f]ederal support

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<sup>30</sup> *Id.*, paras. 51-53.

<sup>31</sup> *Id.*, para. 53.

<sup>32</sup> *Id.*, Furchtgott-Roth, p. 12.

<sup>33</sup> *Federal State Joint Board on Universal Service*, CC Docket No. 96-45, April 10, 1998, Report to Congress, FCC 98-67, para. 197 (emphasis added) (Report to Congress).

<sup>34</sup> The Commission should also clarify that carriers, as well as states, are held harmless for at least their current level of support. Holding only states harmless is inadequate to

should only be used to supplement a state's ability to address its own universal service needs."<sup>35</sup> The Joint Board has taken a step in the right direction by declining to condition the amount of federal support a state receives on actions a state may or may not take regarding its universal service mechanisms.<sup>36</sup> This is an improvement over the FCC's proposal in its Report to Congress, which would have permitted additional federal support only if a state committed to converting its implicit support mechanisms to explicit mechanisms.<sup>37</sup> The Joint Board, however, then goes on to recommend that the amount of support a state receives should be based on a yet-to-be-determined methodology for estimating how much that state can reasonably provide for itself.<sup>38</sup> This amounts to exactly the kind of federal mandate or contingency the Joint Board purports to avoid. Furthermore, the state's citizens will be deprived of comparable rates unless the state bears the burden left by the federal mechanism.

In contrast, Section 254(e) of the Act requires that federal support must be sufficient, in and of itself, to achieve federally-defined universal service. While states cannot burden the federal mechanism by simply abandoning their existing implicit support without attempting to replace it with explicit state support under Section 254(f), there is nothing in the Act to suggest that a federal determination of a state's ability to support their own funding needs should enter the equation of defining "sufficient" federal support. Section 254(f) of the Act permits intrastate funding to be used to advance a state's own universal service goals that extend beyond the federal definitions of universal service.

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protect the customers of individual carriers.

<sup>35</sup> Second Recommended Decision, para. 44.

<sup>36</sup> *Id.*, paras. 26, 36.

<sup>37</sup> Report to Congress, para. 227.

However, a state is under no obligation to adopt a supplementary definition or fund.

Thus, the federal fund cannot rely on those efforts; it must be self sufficient. Without a federal fund that stands on its own, the Commission cannot fulfill its statutory mandate to ensure comparable rates and affordable service nationwide.

The Joint Board's misreading of the Act and the internal inconsistencies found in its recommendation were noted by members of the Joint Board itself. Commissioner Laska Schoenfelder dissented from the recommendation, based in part on the inconsistency of the proposed methodology for calculating federal support levels with both the language of the Second Recommended Decision and the Act:

This method will require a state to fund, implicit[ly] or explicitly, some percentage of the universal service support needed before the federal funding level for the state or carrier is determined. This approach is inconsistent with language contained in the recommended decision that federal support may not be made contingent upon any actions taken, or not taken, by the states. The proposed methodology of determining support calculates a state's contribution to be deducted from the determined level of needed universal support. This calculation in fact produces the same result as a specific requirement for state actions....<sup>39</sup>

Commissioner Harold Furchtgott-Roth also noted that the methodology described in the recommendation "presupposes a universal service burden on the states, establishing a de facto requirement of an intrastate universal service fund."<sup>40</sup>

The Commission will not be able to fulfill its statutory duties as assigned by Congress if it adopts recommendations that are confusing, vague or self-contradictory. Yet the Joint Board's recommendations regarding state and federal responsibility for

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<sup>38</sup> Second Recommend Decision, paras. 44-45.

<sup>39</sup> *Id.*, Schoenfelder, p. 2.

deriving a sufficient level of federal support bear these undesirable characteristics. If adopted, the methodology recommended by the Joint Board would establish a federal fund that merely attempts to plug the gaps left by the undefined “ability” of the states and would thus fall short of the self-sufficient federal support mechanism required by the Act. To comply with the clear meaning of Section 254 and to ensure sufficient support for federally defined universal service to consumers in all areas of the nation, the Commission must reject any plan that relies on states’ ability to contribute to the federal mechanism.

**V. THE COMMISSION SHOULD EXTEND SEVERAL KEY JOINT BOARD RECOMMENDATIONS UNAFFECTED BY RURAL ILEC DIFFERENCES TO APPLY TO RURAL UNIVERSAL SERVICE SUPPORT**

The Commission was prudent not to apply the Second Recommended Decision as a whole to rural ILECs at this time because they are subject to a transition maintaining most of their pre-Act universal service treatment until 2001 at the earliest. However, several of the recommendations correct shortcomings in the May 8 Decision and should be applied to rural telephone companies now or at the appropriate time. Indeed, the Joint Board adopted principles for non-rural companies even though it did not have enough information to recommend a specific mechanism.<sup>41</sup> It can similarly, on a prospective basis, rectify problems with the underlying concepts in the May 8 Decision as they apply to rural ILECs. Specifically, it would be appropriate for the Commission to clarify that the following six principles reflected in the Second Recommended Decision transcend the particular non-rural universal service strategy embraced in the recommendation:

1. The Commission should apply the “hold harmless” approach for non-rural ILEC study areas<sup>42</sup> in implementing both the transitional rural plan and any substitute plan it may later decide to adopt for rural ILEC areas. The “hold harmless” principle is crucial

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<sup>40</sup> *Id.*, Furchtgott-Roth, p. 7.

<sup>41</sup> *Id.*, para. 41.

<sup>42</sup> *Id.*, para. 53.

to ensure stability in the federal support available for the rural telephone companies and customers Congress recognized would need particularized attention during the transition to competition.<sup>43</sup> This approach would help to ensure these ILECs, customers and states that neither a new federal mechanism for rural ILEC areas — nor the operation of the interim cap during the transition period until a new plan is designed and validated — will result in higher local rates, diminished service or delayed access to reasonably comparable rates and services.

2. While the Commission also effectively postponed the applicability of the 25% federal support ceiling until 2001 or later for rural ILEC areas by adopting the rural transition plan, rural ILECs were not excluded from the 25% federal support share. The Commission planned to apply that ceiling in the proxy mechanism it thought should be applied to rural ILECs starting in 2001.<sup>44</sup> The Second Recommended Decision changes the 25% share rule only for non-rural ILECs because the change is tied to the adoption of a modified proxy model mechanism for non-rural ILECs' support mechanism.<sup>45</sup> Thus, it appears that the 25% ceiling remains applicable to rural ILECs in 2001 or later when a new mechanism is adopted for them. This result is probably not intended, but should not be left uncorrected. The 25% ceiling, which the May 8 Decision justified as the existing level of federal loop support, makes even less sense for the rural ILECs. Both their explicit federal high cost loop support under the “old” universal service rules and their Dial Equipment Minutes (DEM) weighting support were calculated in addition to the 25% interstate gross allocator. Consequently, regardless of what means the Commission ultimately chooses to calculate support for rural ILECs, it is not rational to limit federal support to one-quarter of what a mechanism shows to be necessary, let alone to assume that the sharply reduced federal share will be “sufficient,” as the Act demands. Thus, the

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<sup>43</sup> *See, e.g.*, 47 U.S.C. §§ 214(e)(2), 251(f), 253(f).

<sup>44</sup> May 8 Decision, para. 269.

<sup>45</sup> Second Recommended Decision, para. 4.

Commission should clarify that the 25% federal support ceiling in the May 8 decision will also not apply to rural ILECs during or after their transition.

3. The Commission should further clarify that the principle underlying the Joint Board's recommendation that a non-rural high cost mechanism should compare costs with a single nationwide average cost benchmark to determine what costs require support,<sup>46</sup> rather than comparing costs with a nationwide average revenue benchmark in calculating high cost support, should also be an element in any mechanism that may be adopted in the future for rural ILECs. Using nationwide average revenues that include discretionary services and services that are not associated with universal service to determine high costs would assume revenues for services many rural customers cannot yet obtain. And, as the Joint Board pointed out, a cost comparison is a more accurate way to implement the rate comparability principle in Section 254(b)(3) because "rate setting methods and goals may vary across jurisdictions."<sup>47</sup> The rural transitional mechanism, based almost entirely on the pre-Act mechanism, which compares each ILEC's costs with nationwide average costs, has worked well for rural ILEC customers, as Chairman Kennard has recognized.<sup>48</sup> Any replacement developed for rural ILECs should incorporate this rational, time-tested approach.

4. The Commission should also extend to any funding mechanism for rural ILEC support, including the transitional mechanism, the sound principle that carrier universal service contributions will be apportioned on the basis of total unseparated or "non-jurisdictional" end-user revenues.<sup>49</sup> The Joint Board is correct that a non-jurisdictional revenues basis will minimize separations burdens, deter misclassification by carriers that do not perform separations, and better accommodate service packaging. A non-jurisdictional contribution measurement also parallels the non-jurisdictional

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<sup>46</sup> *Id.*, para. 19, paras. 41-43.

<sup>47</sup> *Id.*, para. 43.

<sup>48</sup> *See*, note 5 *supra*.

<sup>49</sup> Second Recommended Decision, para. 63.

measurements, based on unseparated cost information, used to determine the extent to which an individual ILEC's costs are above a national benchmark. Since, unless the Fifth Circuit rules otherwise, the Joint Board recommendation would use total end-user revenues to calculate carrier contributions for non-rural universal service, schools, libraries and rural health care provider support programs, it will maximize carrier convenience and minimize expense and confusion to conform the contributions for support to rural telephone companies.

The RTC does not support the Joint Board's alternative suggestion to consider calculating carrier contributions on a flat per-line basis.<sup>50</sup> That proposal would penalize universal service providers that serve less desirable customers and locations and reward selective providers that serve only the lines and markets that will maximize profits.

5. In evaluating proposals for universal service distribution for non-rural companies, the Joint Board wisely declined to recommend a state block grant system.<sup>51</sup> It relied on long-standing practice, the absence of any indication in the new law or legislative history that Congress intended to abandon direct compensation for the providing carriers, and the need to avoid imposing burdens on states. Any plan ultimately adopted for rural ILECs should also avoid interposing a costly new layer of state administration on the federal support distribution arrangements. The role of the federal universal service program is to spread the cost recovery for nationwide service availability over all providers of interstate services and their customers for the benefit of all the nation's customers and to compensate carriers for providing universal service. It does not empower the Commission to transfer funds among the states, saddle states with federal universal service duties or cede control and supervision of a federal responsibility to the states. The 1996 Act specifies the role of the states in designating eligible telecommunications carriers (ETCs) in Section 214(e), and provides for voluntary separate

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<sup>50</sup> *Id.*

<sup>51</sup> *Id.*, para. 61.

state universal service programs in Section 254(f). The Commission should not substitute a different division of state and federal responsibilities.

6. Although the RTC disagrees with the Joint Board's unlawful preoccupation with preventing growth in the federal universal service fund at all costs, we support the Joint Board's recognition that the Act does not require regulators to make all implicit state and interstate support explicit.<sup>52</sup> That modification allowed the Joint Board to predict that the fund will remain about the same, since letting the states decide when and how to make implicit intrastate support explicit will remove the immediate upward pressure on the federal Universal Service Fund that would otherwise have been necessary.

Notwithstanding the Joint Board's sound general decision not to apply the Second Recommended Decision to rural ILECs, the RTC believes that the Joint Board has properly backed off from the earlier interpretation of the 1996 Act as a federal mandate for state price restructuring, and that decision should be extended to the rural transition plan and any future rural universal service decision. Section 254 nowhere mandates or authorizes the Commission to require states to remove explicit support, and even the federal preference for explicit support is qualified in the legislative history with the phrase "to the extent possible."<sup>53</sup> Delaying the need to confront the universal service costs from making interstate and intrastate support explicit immediately, however, does not mean that the Commission need only preserve the current level of federal support. Accordingly, the RTC strongly endorses the Joint Board's recognition that its prediction that funding will not grow significantly is not a limitation because "[e]nabling reasonably comparable rates among states is a task that can likely be accomplished only with federal assistance."<sup>54</sup> The Joint Board correctly recognizes that, even without massive shifts of implicit to explicit

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<sup>52</sup> *Id.*, paras. 24-26.

<sup>53</sup> Joint Statement of Managers, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. at CR 131 (1996).

<sup>54</sup> Second Recommended Decision, paras. 48-49.

support, “some states may not currently receive support sufficient to enable reasonably comparable rates, and thus we believe the support level may rise somewhat.”<sup>55</sup>

**VI. THE COMMISSION SHOULD REJECT SOME OF THE JOINT BOARD’S STANDARDS AND CONCLUSIONS, OR AT LEAST SHOULD NEVER EXTEND THEM TO RURAL SUPPORT MECHANISMS**

Despite some of the strong improvements upon the May 8 Decision recommended by the Joint Board, some of its conclusions and reasoning are fatally flawed when evaluated under the statute. Section 254 gives the Joint Board and the Commission clear, result-oriented, customer-centered directives for implementing the 1996 Act’s nationwide universal service mandate. Neither the Commission nor the Joint Board has the authority to substitute its own preferences for those enacted by Congress. The Commission should weed the following five errors out of the Joint Board’s recommendation, but in any event it must not extend them in the course of its later consideration of support for rural ILEC areas:

1. One standard which the Joint Board openly applied in its public discussions and decision making, but did not expressly state in the Second Recommended Decision, is the principle of balancing the interests of high cost and low cost states. A majority of the members — accounting for all but one of the votes that were even partially for adopting the recommendation — demonstrated their commitment to the state-balancing test in their separate statements. Commissioner Ness praised the Joint Board for reconciling high and low cost state positions and signaled the intention to continue this process in her separate statement: “Balancing the interests of the high cost and low-cost States will continue to be a challenge, but I believe the framework recommended today represents a major milestone in the implementation of Section 254.”<sup>56</sup> Commissioners Johnson and Baker also disclosed in their joint separate statement that this standard played a large role in the

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<sup>55</sup> *Id.*, para. 49.

<sup>56</sup> *Id.*, Ness, p. 3.

Joint Board's deliberations. They revealed that what they perceived as urban state interests qualified how much support they were prepared to countenance, saying: "While we are committed to ensuring that all citizens, both rural and urban, have fair, reasonable telephone rates, we are concerned that consumers from larger urban states not be overburdened with an unreasonably large high cost fund for nonrural carriers."<sup>57</sup> They professed to favor "sufficient" high cost support, but explicitly conditioned their agreement to the recommendation on a commitment that the mechanism, when completed, "will not unnecessarily burden urban consumers from urban states" and on continued Joint Board involvement in Commission deliberations on universal service and access reform.<sup>58</sup> Commissioner Tristani grounded her support for the Joint Board recommendation on the belief that "it fairly and responsibly balances the need to provide sufficient federal support to carriers serving high cost areas with the need to avoid creating an unreasonably large federal universal service fund."<sup>59</sup>

The statute does not even hint at any state "interests" in the allocation of funding responsibilities among carriers that the Joint Board should take into account. Instead, the principles are all grounded firmly in consumer interests. The whole basis of a nationwide support system is cost-spreading across state boundaries that fairly shares the responsibility for supporting a national asset — wide consumer connection to the public switched telephone network. The only references to the state role to be found in Section 254 are inconsistent with the idea that the nationwide mechanism should avoid imaginary support "flows" from state to state. There is no indication that states have any interest in limiting the aggregate federal support contributions obtained from carriers or recovered from customers within their boundaries inherent in the principle of sufficient Federal and State mechanisms to preserve and advance universal service. Indeed, the Second

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<sup>57</sup> *Id.*, Johnson & Baker, p. 1.

<sup>58</sup> *Id.*, pp. 1-2.

<sup>59</sup> *Id.*, Tristani, p. 1.

Recommended Decision correctly acknowledges that states are allowed, but not required, to adopt state programs, as long as they are not “inconsistent with the federal rules” and do not “burden the federal support mechanism.”<sup>60</sup> Section 254(g) requires interexchange carriers to average their rates across state lines, but does not permit states to intervene on the grounds that, aggregating the interstate calling within their boundaries, the total implicit support “paid” by the state’s low cost interstate customers in averaged rates exceeds the total support “received” from averaged interstate rates by other customers in the state.

The mandate for results enacted by Congress also belies state-by-state analysis. For example, the principle of rural and urban comparability in rates, services and access to advanced telecommunications and information services applies across state lines, as the Second Recommended Decision correctly holds.<sup>61</sup> The required comparability focuses on individual consumers’ rates, not some cumulative statewide report card that purports to show “receiver” and “payer” or “winner” and “loser” states.<sup>62</sup> The duty to ensure that support is sufficient, but not more than is necessary for the statutory purposes to which all support must be devoted, is also a protection for customers, not states. To comply with the statute Congress enacted, the Commission should give no weight to arguments that nationwide support spreads more costs to customers in states with the largest urban concentrations.

2. The requirements that federal funding be “sufficient” and that carriers use support only for intended universal service purposes are also the only lawful measure of the federal fund’s size. It is perfectly valid for the Joint Board to seek to maintain nationwide funding at a level that does not unnecessarily burden any consumer group. But it is patently unlawful for the Joint Board or the Commission to treat preventing significant

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<sup>60</sup> *Id.*, para. 24; *see*, 47 U.S.C. § 254(f).

<sup>61</sup> *Id.*, paras. 18, 37, 48.

<sup>62</sup> *See, e.g., Telecommunications Industries Analysis Project, Payers and Receivers: Various Proposals for the High Cost Fund* (March 10, 1998; revised April 22, 1998).

growth of the federal fund over its current level as an independent test of a suitable federal mechanism. The Joint Board has come perilously close to adopting this test here, and cannot avoid the future determination of whether the funding is “sufficient” when the mechanism has been completed. It should be extremely careful to apply the statutory sufficiency standard — not a fund size test — when it turns later to further consideration of a rural ILEC support mechanism.<sup>63</sup>

3. The Commission should also abandon its practice of affording competitive “neutrality” the paramount position in its hierarchy of universal service criteria. While the Commission is fully justified in trying to limit adverse impact on competition in implementing the federal universal service mechanisms, it was the Commission that grafted that test onto Section 254, not Congress. The ultimate legal standard for universal service decisions is whether customers will enjoy the rate and service benefits set forth in Section 254, not whether the Commission or competitors find the support mechanism congenial to new entry in rural areas.<sup>64</sup> Congress adopted rural safeguards in Section 254(f) allowing states to regulate entry to prevent harmful cream skimming and unwarranted portability of rural support.<sup>65</sup> A more reasonable conclusion from the structure and content of the 1996 Act is that Congress legislated portability as the means to achieve competitive neutrality in the context of universal service and left it to each state to decide when to impose that requirement in rural ILEC areas.

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<sup>63</sup> As Commissioner Ness observed at the October 30, 1998, open meeting of the Joint Board in response to calls for a fund no larger than the current explicit support, to the extent that the shift from implicit to explicit support goes forward, it is hard to imagine how the federal fund could fail to grow beyond its current size. The RTC believes that any cap on fund size imposed by the Commission and applied to deny support that would otherwise be payable under the applicable support mechanism would represent unreasonable discrimination against the affected customers and would be unable to pass judicial muster.

<sup>64</sup> Second Recommended Decision, para. 56.

<sup>65</sup> See also, 47 U.S.C. §§ 214(e)(3), 254(e).

4. The Joint Board recommends reverting to the study area level to measure and distribute support in nonrural ILEC areas to limit the role of federal support to what is needed to meet disparities among study areas and among states.<sup>66</sup> Its rationale is evidently that, in view of the current level of competition, federal support is not necessary to replace implicit support now provided by averaging within study areas. The Joint Board admits that when competition is more widespread “using the aggregate characteristics of the study area may become less appropriate.” However, the problems with making study area-wide support portable arise before competition is even established. The Joint Board fails to come to grips with the distorted entry incentives and adverse consumer effects that its flawed system of support portability will create with study area-wide support measurement and distribution. The problem is that additional eligible carriers will be able to draw support based on the average support for the incumbent’s study area, even if the CETC serves only the lowest cost portion of the study area or serves all the high cost portions through resale of the ILEC’s supported high cost loops. That result is unfair, since the CETC will receive average study area support even though it is free to serve with facilities only where its costs are well below that average.<sup>67</sup>

The Joint Board has a notion that a state could rectify this anomaly by permitting states to require CETCs to target the study area wide support to “consumers living in the highest cost areas within a study area.”<sup>68</sup> However, if the CETC serves the high cost parts by resale, it can satisfy this requirement by using the support to reduce the already supported resale cost of the lines it resells. It would thus be obtaining support for resold lines and using it to compete unfairly against the ILEC. A CETC’s service area, moreover, is not required to mirror the ILECs’ study area (except, until changed, in rural

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<sup>66</sup> Second Recommended Decision, paras. 32-33.

<sup>67</sup> The ILEC’s costs for those portions of the service area would also be below the study area average if such averaging were not required. The new ETC thus gets windfall support.

<sup>68</sup> Second Recommended Decision, para. 58.

ILEC areas),<sup>69</sup> so the highest cost parts of the CLEC's service area may not be within the high cost parts of the ILEC's study area at all.

The ILEC's customers in the high cost parts of the study area would bear the brunt of the windfall average support diverted to the CLEC. This is because the loss of each below average cost customer to the CLEC will nevertheless deprive the ILEC of the average per line study area support, which erodes the contribution such lines had previously made to the higher cost portions. The ILEC must then either raise its rates for these high cost residual customers, receive more universal service support (adding to the burden passed through to contributing carriers' customers) or bear the financial consequences of not recovering its costs for service required of it as carrier of last resort. Requirements for the CLEC that gets the support to target it to its highest cost customers would do nothing to put the support back in the hands of the carrier whose facilities serve the above average cost customers. This same concern also applies at present to rural ILECs under the transition plan, since CLECs in their areas get the ILEC's average study area support per line for customers served in the low cost portions, regardless of whether they serve the high cost lines through the resale of ILEC lines.

The only way to mitigate the mismatch between study area support averaging and portability — other than disaggregating support — is to confine portability to CETCs that serve the same study area and range of locations and customers as the ILEC upon whose study area the portable average support per line is based. As long as support is available on a study area average basis to CLECs that do not need to incur the true costs of study area wide service, there will be a perverse incentive for CLECs to become CETCs to take advantage of the mismatch.

## **VII. THE JOINT BOARD PROPERLY RECOMMENDED COMMISSION GUIDANCE ON THE CHARACTERIZATION OF UNIVERSAL SERVICE CHARGES TO CONSUMERS**

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<sup>69</sup> 47 U.S.C. § 214(e)(5).

The RTC agrees with the Joint Board's recommendation that the Commission provide carriers with guidance regarding the manner in which their bills may depict charges used to recover contributions.<sup>70</sup> In the interest of truth in billing, carriers who choose to itemize charges should be required to disclose that high cost support has been included in rates in the past. The Commission's commitment to universal service for high cost areas is not new and should not be presented in a way that makes it appear like a new federal program. The Joint Board correctly believes that it is important for consumers to understand that "universal service support has long been implicit in the rates for various intrastate and interstate telecommunications services."<sup>71</sup> Consumer understanding that support for universal service is not a new burden, and that communicating with many areas of the country might not be possible without it, can only enhance the Commission's ability to successfully implement the goals of the Act. The Commission's goal, mandated by Congress, of preserving and advancing universal service should not be thwarted by misrepresentations or mischaracterizations of surcharges and line item pass throughs as "taxes" or "fees" required by federal regulations to be separately collected from the consumer when such is not the case.

**VIII. IN MAKING IMPLICIT INTERSTATE SUPPORT EXPLICIT, THE COMMISSION MUST PREVENT DOUBLE RECOVERY WITHOUT SHIFTING SUPPORT BURDENS TO THE INTRASTATE JURISDICTION**

The Joint Board has explained more fully how it expects the Commission to deal with interstate implicit support the Commission makes explicit.<sup>72</sup> The Joint Board

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<sup>70</sup> Second Recommended Decision, para. 70.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*, paras. 20-23.

recognizes the relationship to the Commission's access charge reform proceeding and recommends that the Commission consult with the Joint Board before making further interstate support explicit. The RTC agrees that when the Commission shifts support that is now implicit in access charges into the federal universal service support mechanism, the same costs should not be recovered both in universal service support and interstate access charges. However, the assumption that there is no direct effect on intrastate rates from such changes is misleading.<sup>73</sup> Unless the Commission funds all the shifted support from the federal share of a universal service mechanism, the remainder of the costs would be left for either intrastate support or intrastate rates to recover. To ensure that such support is actually replaced when it is removed from access charges, the "hold harmless" support to be preserved for ILECs should be increased by the amount of any support the Commission removes from interstate access charges or has shifted from Long Term Support and DEM-weighting support into the new Universal Service Fund.

## **IX. CONCLUSION**

The Joint Board's recommendation goes a long way toward correcting some of the problems in the May 8 decision, but there are several misconceptions in the recommendation which must be addressed.

For the above detailed reasons, the Commission should recognize that the Joint Board properly excluded rural ILEC areas in reaffirming the use of a FLEC proxy model. It should also follow the Board's recommendation and abandon the 25% federal support ceiling for non-rural support and instead focus on providing the level of federal support that achieves "reasonably comparable" rural and urban rates. However, the Joint Board's

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<sup>73</sup> *Id.*, para. 22.

assertion that federal support should only serve to supplement state support is contrary the Act.

As detailed in the above comments, the Commission should extend six key Joint Board recommendations to rural ILECs which rectify problems with the underlying concepts in the May 8 Decision. The six salutary principals in the non-rural recommendation are unaffected by rural ILEC differences. The Commission should discard, or at least not extend to rural ILEC support, several errors in the recommendation as described above. Finally, reasoned guidance from the Commission would be helpful to prevent the mischaracterization of the nature of universal service, and shifts from implicit to explicit support should prevent “double recovery” without burdening the intrastate jurisdiction with new costs.

Respectfully submitted,

**THE RURAL TELEPHONE COALITION**

**NRTA**

By:

Margot Smiley Humphrey

Koteen & Naftalin, LLP  
1150 Connecticut Ave., NW

**NTCA**

By:

L. Marie Guillory  
Jill Canfield

2626 Pennsylvania Ave., NW  
Washington, DC 20037

**OPASTCO**

By:

Stuart Polikoff  
Stephen Pastorkovich

21 Dupont Circle, NW  
Suite 700

Washington, DC 20036

(202) 467-5700

(202) 298-2359

Washington, DC 20036

(202) 659-5990

December 22, 1998

## **CERTIFICATE OF SERVICE**

I, Tiffani N. Belk, hereby certify that on this, the 23rd day of December, 1998, a copy of the Rural Telephone Coalition's comments was sent by United States mail, first class, postage prepaid, or hand delivered, to those listed on the attached sheet.

Tiffani N. Belk

**SERVICE LIST**  
**CC DOCKET NO. 96-45**  
**DA 98-2410**

The Honorable William E. Kennard  
Chairman  
Federal Communications Commission  
1919 M Street, NW, Room 814  
Washington, DC 20554

The Honorable Michael Powell  
Commissioner  
Federal Communications Commission  
1919 M Street, NW, Room 844  
Washington, DC 20554

The Honorable Susan Ness  
Commissioner  
Federal Communications Commission  
1919 M Street, NW, Room 832  
Washington, DC 20554

The Honorable Harold Furchtgott-Roth  
Commissioner  
Federal Communications Commission  
1919 M Street, NW, Room 802  
Washington, DC 20554

The Honorable Gloria Tristani  
Commissioner  
Federal Communications Commission  
1919 M Street, NW, Room 826  
Washington, DC 20554

The Honorable Julia Johnson  
Commissioner  
Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Gerald Gunter Building  
Tallahassee, FL 32399-0850

The Honorable David Baker

Commissioner  
Georgia Public Service Commission  
244 Washington Street, SW  
Atlanta, GA 30334-5701

The Honorable Laska Schoenfelder  
Commissioner  
South Dakota Public Utilities  
Commission  
State Capitol, 500 East Capitol Street  
Pierre, SD 57501-5070

The Honorable Martha S. Hogerty  
Secretary of NASUCA  
301 West High Street, Suite 250  
Truman Building  
P.O. Box 7800  
Jefferson City, MO 65102

Charles Bolle  
Public Utilities Commission of Nevada  
1150 East William Street  
Carson City, NV 89701

Irene Flannery  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8922  
Washington, DC 20554

Paul Gallant  
Federal Communications Commission  
1919 M Street, NW, Room 826  
Washington, DC 20554

Lori Kenyon  
Alaska Public Utilities Commission  
1016 West Sixth Avenue, Suite 400  
Anchorage, AK 99501

Mark Long

Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Gerald Gunter Building  
Tallahassee, FL 32399-0866

Sandra Makeeff Adams  
Iowa Utilities Board  
350 Maple St.  
Des Moines, IA 50319

Kevin Martin  
Federal Communications Commission  
1919 M Street, NW, Room 802  
Washington, DC 20554

Philip F. McClelland  
Pennsylvania Office of Consumer  
Advocate  
1425 Strawberry Square  
Harrisburg, PA 17120

Thor Nelson  
Colorado Office of Consumer Counsel  
1580 Logan Street, Suite 610  
Denver, CO 80203

James Casserly  
Federal Communications Commission  
1919 M Street, NW, Room 832  
Washington, DC 20554

Rowland Curry  
Texas Public Utility Commission  
1701 North Congress Avenue  
P.O. Box 13326  
Austin, TX 78701

Brian Roberts  
California Public Utilities Commissions  
505 Van Ness Avenue  
San Francisco, CA 94102

Patrick H. Wood, III

Texas Public Utility Commission  
1701 North Congress Avenue  
P.O. Box 13326  
Austin, TX 78711-3326

Walter Bolter  
Florida Public Service Commission  
Gunter Building, Suite 270  
2540 Shumard Oak Blvd.  
Tallahassee, FL 32399-0850

Doris McCarter  
Ohio Public Utilities Commission  
180 E. Broad Street  
Columbus, OH 43215-3793

Mary E. Newmeyer  
Alaska Public Service Commission  
100 N. Union Street, Suite 800  
Montgomery, AL 36104

Linda Armstrong  
Federal Communications Commission  
CCB, Accounting and Audits Division  
2100 M Street, NW, Room 8608  
Washington, DC 20554

Craig Brown  
Federal Communications Commission  
CCB, Accounting and Audits Division  
2100 M Street, NW, Room 8613  
Washington, DC 20554

Barry Payne  
Indiana Office of the Consumer Counsel  
100 North Senate Avenue, Rm. N501  
Indianapolis, IN 46204-2208

Brad Ramsey  
NARUC  
1100 Pennsylvania Ave, NW  
P.O. Box 684  
Washington, DC 20044-0684  
Tiane Sommer  
Georgia Public Service Commission

47 Trinity Avenue  
Atlanta, GA 30334

Peter Bluhm  
Vermont Public Service Board  
Research Drawer 20  
112 State St., 4th Floor  
Montpieller, VT 05620-2701

Carl Johnson  
New York Public Service Commission  
3 Empire State Plaza  
Albany, NY 12223-1350

Susan Stevens Miller  
Maryland Public Service Commission  
16th Floor, 6 Paul Street  
Baltimore, MD 21202-6806

Tom Wilson  
Washington Utilities & Transportation  
Commission  
1300 Evergreen Park Drive, SW  
P.O. Box 47250  
Olympia, WA 98504-7250

Lisa Boehley  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8924  
Washington, DC 20554

Steve Burnett  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW Room 8618  
Washington, DC 20554

Bryan Clopton  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8615  
Washington, DC 20554

Lisa Gelb  
Federal Communications Commission

CCB, Accounting Policy Division  
2100 M Street, NW, Room 8601A  
Washington, DC 20554

Charles L. Keller  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8918  
Washington, DC 20554

Robert Loube  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8609  
Washington, DC 20554

Sumita Mukhoty  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8621  
Washington, DC 20554

Kaylene Shannon  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8907  
Washington, DC 20554

Matthew Vitale  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8600  
Washington, DC 20554

Sharon Webber  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8920  
Washington, DC 20554

Adrian Wright  
Federal Communications Commission

CCB, Accounting Policy Division  
2100 M Street, NW, Room 8614  
Washington, DC 20554

Andrew Firth  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8400B  
Washington, DC 20554

Emily Hoffnar  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8617  
Washington, DC 20554

Katie King  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8625  
Washington, DC 20554

Brian Millin  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8403  
Washington, DC 20554

Mark Nadel  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8916  
Washington, DC 20554

Richard D. Smith  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8612  
Washington, DC 20554

Melissa Waksman  
Federal Communications Commission

CCB, Accounting Policy Division  
2100 M Street, NW, Room 8914  
Washington, DC 20554

Jane Whang  
Federal Communications Commission  
CCB, Accounting Policy Division  
2100 M Street, NW, Room 8905  
Washington, DC 20554

William Gillis  
Washington Utilities and Transportation  
Commission  
P.O. Box 47250  
Olympia, WA 98504-7250

Robert Schoomaker  
GVNW, Inc.  
2270 La Montana Way  
Colorado Springs, CO 80918

Thomas Beard  
Utilicore  
1549 State Street  
Sarasota, FL 34236

Carol Ann Bischoff  
Competitive Telecommunications  
Association  
1900 M Street, Suite 800  
Washington, DC 20036-3508

Jack Brown  
Golden West Telecommunications  
Cooperative, Inc.  
410 Crown Street  
P.O. Box 411  
Wall, SD 57790-0411

David Conn  
McLeod USA, Inc.

McLeod USA Technology Park  
6400 C Street NW  
P.O. Box 3177  
Cedar Rapids, IA 52406-3177

Gene DeJordy  
Western Wireless Corp.  
3650 - 131st Avenue, SE  
Suite 400  
Bellevue, WA 98006

Billy Jack Gregg  
West Virginia Consumer Advocate  
Division  
723 Kanawha Blvd., East  
700 Union Building  
Charleston, WV 25301

Evelyn Jerden  
Western New Mexico Telephone  
Company  
4070 N. Circulo Manzanillo  
Tucson, AZ 85750

Elstun Lauesen II  
Tanana Chiefs Conference, Inc.  
P.O. Box 80827  
College, AK 99708

Joel Lubin  
AT&T  
295 N. Maple Avenue, Room 5462b3  
Basking Ridge, NJ 07920

Joan Mandeville  
Blackfoot Telephone Company  
1221 N. Russell Street  
Missoula, MT 59802-1898

Chris McLean  
USDA, Rural Utilities Service

1400 Independence Avenue, SW  
Mail stop: 1510  
Washington, DC 20250

Gwen Moore  
GEM Communications  
4201 Wilshire Boulevard, Suite 301  
Los Angeles, CA 90010

Jack Rhyner  
Telalaksa  
2121 Abbot Road  
Anchorage, AK 99507

Jack Rose  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, AZ 85007

David Sharp  
Virgin Islands Telephone Corp.  
P.O. Box 7610  
St. Thomas, VI 00801

Steven Ward  
State of Maine Public Advocate Office  
112 State House Station  
193 State Street  
Augusta, ME 04333-0112

ITS  
1231 20th Street, NW  
Washington, DC 20036